No. 15399

In the United States Court of Appeals for the Ninth Circuit

EDWARD POOL AND LOTTIE POOL, EDWARD POOL, LOTTIE POOL, WILLIAM K. MURPHY, EDNA MURPHY, WILLIAM K. MURPHY AND EDNA MURPHY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petitions for Review of the Decisions of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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CITATIONS

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 29-88) are not officially reported.

JURISDICTION

This appeal covers six cases which were consolidated by order of the Court (R. 533-535) and originated with the Commissioner's action in determining income tax deficiencies against taxpayers for 1946, 1947 and 1948 (R. 8-12). Taxpayers filed petitions

for review of the deficiencies (see R. 3, 5-8)[1] under the provisions of Section 272 of the Internal Revenue Code of 1939. The decisions of the Tax Court were entered on August 20, 1956. (R. 89-94.) Petitions for review by this Court were filed on November 5, 1956. (R. 95-97.) This Court accordingly has jurisdiction of the cases under Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court erred in concluding that the 70 duplexes on Tract 11451 sold in 1946 and the 99 duplexes on Tract 13163 sold in 1946 and 1947 were held by taxpayers primarily for sale to customers in the ordinary course of their business and that, accordingly, the profits realized from the sale thereof constituted ordinary income, rather than capital gain under 1939 Code Section 117.[2]

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

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[1] The record references to the petitions for review by the Tax Court and by this Court are to the documents filed in but one of the six cases, since, pursuant to the Court's order (R. 533-535), the documents in the other cases have not been printed.

[2] The sales, although made in 1946 and 1947, were made in the fiscal years ended January 31, 1947, and January 31, 1948, of Edward Pool and Associates, a joint venture (or partnership) of the four individual taxpayers, and the profits therefrom were therefore earned by and includible in the 1947 and 1948 incomes of the four individual taxpayers.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [as amended by Sec. 115(b) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 151 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section

23(1) * * * or real property used in the trade or business of the taxpayer.

* * * *

(j) [as added by Sec. 151 (b) of the Revenue Act of 1942, *supra*] *Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(2) *General rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion * * * of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales

> or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. * * *
>
> * * * *

(26 U.S.C. 1952 ed., Sec. 117.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> SEC. 29.117-1. *Meaning of Terms.*— * * *
>
> The exclusion from the term "capital assets" of * * * real property used in the trade or business of a taxpayer is limited to such property used by the taxpayer in the trade or business at the time of the sale, exchange, or involuntary conversion. * * *
>
> * * * *

STATEMENT

The Tax Court's findings of fact (R. 33-70) include stipulated facts (R. 33) and cover two issues. The findings bearing on the one issue which has been appealed may be restated as follows:

The taxpayers Edward Pool and Lottie Pool are husband and wife, as are the taxpayers William K. Murphy and Edna Murphy. Each couple filed their income tax returns on a cash basis and by calendar years. For the year 1948 each couple filed a joint return. (R. 33.)

Upon the organization in 1941 of Artcraft Builders, Inc. (hereinafter called Artcraft), for the purpose of engaging in residential building construction, tax-

payers Edward Pool and William K. Murphy each acquired shares of the Class B common stock of the corporation. The remaining shares of stock were owned by R. T. and Mary Cooke and J. S. A. and Gertrude C. Smith. Taxpayer Edward Pool had been a builder during all of his business life and was named president of Artcraft. Throughout his operations he had sold all of his houses through brokers, never having had a real estate broker's license or having sold any houses personally. Taxpayer William K. Murphy's employment with Artcraft was that of sales manager. (R. 34-35.)

During 1942 the major portion of Artcraft's income was derived from building houses for sale for its own account, although it did have some income from building contracts. In 1942 it built for sale on its own account and sold 142 houses in Los Angeles County. In 1943 it built for sale on its own account and sold 188 houses, all of which were likewise located in Los Angeles County. It derived no income in 1943 from building under contract for others. (R. 34-35.)

After the subject of building residential income units had been brought up and at first turned down and then held open for future consideration, Artcraft on February 24, 1943, made application to the Federal Housing Administration of the War Production Board to build for war housing 22 multiple dwelling structures, containing 68 family units, in Tract No. 11674 and on May 26, 1943, made application to build 70 duplexes, containing 140 units, in Tract 11451, both tracts being located near Long Beach and

the Douglas Aircraft plant. These projects were to be and were financed through F.H.A. Title VI loans with Western Federal Savings and Loan Association of California. As a part of its application in each instance, Artcraft agreed that it would hold for rent the accommodations contemplated at rentals per unit not in excess of monthly charges designated in the application, except as otherwise authorized by General Orders 60-2 and 60-3 of the National Housing Agency, and that it would not include in the lease of the accommodations any option to purchase except in accordance with the general orders; and, further, that, except as authorized by the general orders, it would not otherwise dispose of or enter into any agreement or contract for the disposal of any of the accommodations, or any title interest, and that it would notify any transferee of the accommodations that he must comply with the provision of the general order relative to occupancy. (R. 35-37.)

Artcraft's application, filed on February 23, 1943, for approval of the proposed construction of 22 multiple dwelling units on Tract 11674, was approved by the Federal Housing Administration on June 1, 1943, and by the War Production Board on June 7, 1943. The application, filed on May 26, 1943, for approval of the proposed construction of 70 duplexes on Tract No. 11451, was approved by the Federal Housing Administration on June 7, 1943, and by the War Production Board on June 16, 1943. (R. 38.)

General Orders 60-2 and 60-3 were part of the Operating Manual, National Housing Agency, General Order No. 60-2 being designated "Public Regu-

lations—Occupancy and Disposition of Private War Housing", and General Order No. 60-3, as "Public Regulations—Methods of Disposition of Private War Housing Including Rent Levels, Sales Prices, and Petitions to the National Housing Agency". (R. 38.)

General Order 60-2 recited that the National Housing Agency was responsible for the proper occupancy of housing programmed for war workers and for the adoption of regulations assuring that war housing would be held available for eligible war workers for the duration of the national emergency declared by the President on September 8, 1939. Under the order, private war housing was to be regarded as "begun" on the date of submitting to the Federal Housing Administration a properly executed application for priority assistance or authority to begin construction in connection with such housing, and the date of "completion" was to be the date upon which such housing was offered for initial rental or sale, or the date upon which it was first ready for immediate occupancy, whichever was later. The phrase "held for rental" included "only an ordinary landlord-tenant relationship or such a tenancy coupled with an option to purchase". Under the option, the tenant was not to be obligated to purchase and the option was to run only in his behalf. The selling price was to "be a fair market price, or $6,000", whichever was lower. The option to purchase could not be exercised prior to the expiration of four months' occupancy, and was to continue for at least 30 months, unless sooner exercised. Private war housing begun on or after February 10, 1943,

was to be made available for initial occupancy, and for reoccupancy, only by eligible war workers. It was provided, however, that at any time subsequent to 60 days after completion of such housing, the owner might petition the National Housing Agency to permit initial occupancy, or reoccupancy, as the case might be, by a person other than an eligible war worker. Except for involuntary transfers, private war housing could be disposed of (a) only to an occupant, after four months' occupancy; (b) to a person who would not himself occupy the housing, provided the occupancy and disposition limitations applicable prior to purchase or acquisition should continue to be applicable after such purchase or acquisition; or (c) at any time subsequent to 60 days after completion of any such housing, the owner might petition the National Housing Agency to permit disposition otherwise than as indicated in (a) and (b). (R. 38-40.)

General Order 60-3 was designed to implement the occupancy and disposition policies of the National Housing Agency applicable to all private war housing as stated in General Order No. 60-2. It also provided that for the duration of the national emergency declared by the President on September 8, 1939, all private war housing begun on or after February 10, 1943, should be held for rental to eligible war workers as provided in General Order No. 60-2, at the rentals specified in the application, which rentals should in no event exceed $50 per month shelter rent for one unfurnished dwelling unit, plus a reasonable charge for tenant services, which was

not to exceed $3 per month per room. It also carried provision that "a dwelling unit * * * may be purchased by an occupant * * * after four months of continuous occupancy", but that the purchase price might not exceed the fair market price, or $6,000, whichever was lower. In the case of such sale, the seller was required to submit an agreement on the part of the purchaser that such purchaser would continue to occupy the dwelling unit, or would hold the unit subject to the occupancy and disposition provisions set forth in General Order No. 60-2. Subject to the same restrictions as to price, such houses could also be transferred to a person who would not become an occupant thereof, but only if an agreement was submitted stating that the housing would be held subject to the provisions of General Order No. 60-2. Further, at any time subsequent to 60 days after completion, the original owner or a subsequent owner might petition the National Housing Agency to permit disposition otherwise than as provided above. (R. 40-41.)

General Order No. 60-3 was thereafter superseded by General Orders Nos. 60-3A, 60-3B, which became effective August 25, 1943, and 60-3C, which became effective November 12, 1943. So far as appears, the superseding orders were, for the purposes here, substantially the same as General Order No. 60-3. (R. 41.)

On June 1, 1943, after additional shares of Artcraft Class B common stock had been authorized and issued to taxpayers Edward Pool and William K. Murphy and to the Smiths and Cookes, taxpayers

purchased all of the stock held by the Smiths and Cookes. On June 8, 1943, Smith and Cooke resigned as officers and directors of the corporation. At all times thereafter, taxpayers (Edward Pool and William K. Murphy and their wives) were the sole stockholders of Artcraft. (R. 37-38.)

At a special meeting of Artcraft's board of directors held on September 16, 1943, the corporation, pursuant to taxpayers' desire, agreed to turn over to the four taxpayers, as tenants in common, the 22 lots in Tract 11674 and the 70 lots in Tract 11451, together with all buildings erected thereon, and that money obtained from loans over and above the actual cost of the buildings should also be transferred to them as tenants in common, in consideration for which the corporation was to retain all rentals and payments received upon any of the buildings until the time the property was transferred to taxpayers. Taxpayers were not to assume any personal responsibility but agreed that, so long as rentals or sales of the properties produced sufficient funds, such funds would be used to liquidate encumbrances upon the properties. The actual transfer of the properties was made later, pursuant to a special meeting of Artcraft's board of directors held on March 31, 1944, the date on which all of the buildings on Tracts 11674 and 11451 were completed. (R. 41-43, 44-46.)

Generally speaking, the dwelling units on Tracts 11674 and 11451 were rented as construction was completed. The first unit to be rented was in one of the 22 apartment buildings on Tract 11674. It was rented on the day before Thanksgiving in 1943.

The terms and conditions under which the housing was rented, including rental rates, were in keeping with the requirements of General Orders Nos. 60-2 and 60-3. The initial leases were for a period of one year. A few of the apartments may thereafter have been leased for longer periods. (R. 44.)

On or about April 1, 1944, taxpayers "formed a joint venture (or partnership) known as Edward Pool and Associates" (hereinafter called Associates), which was formed for the purpose of holding and dealing with the properties which had been transferred by Artcraft to taxpayers. Associates kept its books under an accrual method of accounting and on the basis of a fiscal year ending January 31. It filed partnership returns of income, Form 1065, for the fiscal years ended January 31, 1945, through January 31, 1950, inclusive. It maintained no office as its own and did not purport to have any employees. Its books and accounts were kept by a Mrs. Woodruff, who was carried as an employee of Artcraft, no part of her salary being charged as such to Associates. (R. 46-47, 55.)

At some time prior to June 14, 1944, Pool and Murphy began the construction of a market building on a lot owned by them and their wives in Long Beach. The actual construction work was done for them by Artcraft. There was no written contract or agreement with respect to the work Artcraft was doing, but at a special meeting of Artcraft's board of directors on June 14, 1944, after Pool had recited that Artcraft was doing the work for the individuals named "upon a basis of cost plus 10%", a motion

was made, and carried, that the contract for construction of the market building in the terms stated be ratified, confirmed and approved. The completed cost of the market building to the four individuals was $51,409.95. At all times since its completion, the building has been rented, and at the time of the trial herein was still owned by the four individuals. (R. 47.)

Under date of January 4, 1945, Artcraft made a priorities application to the National Housing Agency of the Federal Housing Administration for the construction of 100 duplexes on Tract No. 13163 in Long Beach. As in the case of the construction heretofore described on Tracts 11674 and 11451, Artcraft, as a part of its application, represented that it would hold the proposed accommodations for rent and would rent them only to eligible war workers as defined in the National Housing Agency's General Order No. 60-1, and that any sales thereof would be only as permitted by National Housing General Orders Nos. 60-2 and 60-3; and further, that rents and other charges to tenants would not be in excess of the amounts thereafter shown in the application, which schedule indicated a charge of $42.50 as shelter rent and $7.75 as a charge for services, making a total charge of $50.25 per month. In making the application, Artcraft represented itself as the project owner. The application was approved under date of February 5, 1945. This project was financed through F. H. A. insured loans from Western Federal Savings and Loan Association aggregating $724,685. (R. 47-48.)

As in the case of the lots and buildings on Tracts 11674 and 11451, Artcraft, at a special meeting of its board of directors held on February 26, 1945, agreed to transfer the 100 lots in Tract 13163, together with any and all buildings and improvements erected thereon, to taxpayers as tenants in common. The transfer was made by deed dated March 21, 1946, pursuant to resolution adopted at a regular meeting of Artcraft's board of directors held on February 1, 1946, after all of the buildings and improvements (the 100 duplexes) had been completed. (For details of the agreement and execution thereof, see R. 48-52.)

Only Tracts 11451 and 13163 are directly involved here. Tract 11451 with the improvements cost Artcraft $477,947.74 and it was at that amount that the property was transferred by Artcraft to the four taxpayer-stockholders. Artcraft had received F.H.A. insured loans on the tract, through Western Federal Savings and Loan Association, of $525,000. The difference between the $525,000 and the $477,947.74, amounting to $48,052.26, was made available by credit entries to Associates. Tract 13163 with improvements was transferred by Artcraft to the taxpayer-stockholders at its cost of $624,220.02 and the excess of F.H.A. insured loans on the tract, amounting to $100,464.98, was transferred to taxpayers by credit entries. (Stip. pars. 15, 16, 20, R. 22-23, 25-27.)

The 100 duplexes on Tract 13163 were leased as they were completed, all of the leases being for a

period of one year. The dates of completion were in June, July and August of 1945. (R. 54.)

From time to time, a tenant would inquire as to whether the housing occupied by him under the lease might be purchased. None of the leases carried a purchase option provision, however, and the tenant was advised that the houses were not for sale. The same response was given to non-tenants making similar inquiries on various occasions. (R. 54.)

After the transfer of title to the 22 apartment buildings and the 70 duplexes by Artcraft to the taxpayer-stockholders in 1944, and the similar transfer of title to the 100 duplexes in 1946, the rental of the apartments and duplexes was continued from Artcraft's office and in Artcraft's name. Mrs. Woodruff, who did Artcraft's bookkeeping and also kept Associates' books, handled the transfer of rentals to taxpayers. Associates paid Artcraft for services performed as "rental agent". (R. 55-56.)

Effective October 15, 1945, "sales ceilings on all priority assisted housing" were removed, but "OPA controls over rental remained". At some time in 1945 or early 1946, an application was made by Associates and/or Artcraft for permission to increase the rents being charged on the apartments and duplexes, but the application was denied. As to the 170 duplexes, and upon advise of counsel, a practice was later adopted of not renewing leases when they expired. Thereafter a tenant, upon expiration of his lease, would continue in the premises under a month-to-month tenure. The date of the last of the written leases on any of the 100 duplexes on Tract 13163 was April 10, 1946. (R. 54.)

After the lifting of the ceiling on the sale prices for war housing in October of 1945, and as veterans returned and began looking for homes, a very substantial upward trend, particularly in 1946, became noticeable in the selling prices such housing was commanding. (R. 57.)

At some time in January or February of 1946, Philip Boland, who throughout his business life had been engaged in some activity as a real estate broker, was on terminal leave from the Air Force. During that period he was visiting "different people" he knew, among them Pool and Murphy, who showed him the properties they had constructed and then owned. Boland, casually but not seriously, because he did not know where he would locate, suggested that Pool and Murphy permit him to sell the properties for them. The proposal was not accepted. At some time in April of 1946, Boland approached Pool and Murphy in a serious effort to induce them to permit him to sell the apartment buildings and the 170 duplexes. He argued that the then present was the best time to cash in on property, that everybody wanted to buy but there was nothing to sell, and that the demand was great for any kind of living quarters. Murphy saw it his way, and it was not until later that Pool "more or less reluctantly" agreed to go ahead and sell some of the units,[3] the units then

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[3] It was Pool's testimony that Murphy got rather enthusiastic as the prices went up, but that he, Pool, still did not want to sell them. He also testified, "We got so much advice from Mr. Boland, Mr. Boland was so persistent on what they could do, the prices he could get, and naturally there

agreed upon being 70 duplexes on Tract 11451. For his services, Boland at first sought the "straight five per cent commission" which was "more or less traditional" in that area. After some discussion, an agreement was reached that the taxpayers would supply the office facilities, including telephone and some secretarial and office help, and that Boland should be compensated at the rate of $500 for each building sold. (R. 57-58.)

In the course of his negotiations with Pool and Murphy for permission to sell the duplexes, Boland visited the Los Angeles offices of the Bureau of Internal Revenue and was referred to various rulings and regulations dealing with the sale of the property. He had at one time been an employee of the Bureau. After reading the rulings and regulations, he advised Murphy that in his opinion the gains realized upon the sale of the properties would be capital gains. (R. 58.)

On some undisclosed date, but after December 31, 1945, the certified public accountant who looked after the books of Artcraft and of Associates had undertaken to convince Pool and Murphy that they should sell the duplexes and possibly the apartment buildings. Pointing out that they were restricted in the receipt of rental income by rent control, and stating that in his opinion the prevailing prices for such property were at a peak and would be not be as favorable thereafter, he argued that the sales proceeds could be put into more favorable income-producing prop-

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was quite a profit on them, and they just finally overrode me, that's all". (R. 58.)

erties. And while the figures disclosed a rather substantial rental income, he made some tabulations which were designed to show that if depreciation should be computed on the current selling prices for such housing, instead of cost, no profit from rental would be reflected. On or about the first of May 1946, Murphy inquired as to whether the gains upon sale of the properties would receive capital gains treatment. He was taken by the accountant to his senior in the firm, who advised Murphy that the gains would be taxable as capital gains. (R. 58-59.)

Boland conducted his selling activities in and from the offices maintained under Artcraft's name, and was assisted in the office and paper work by Mrs. Woodruff. He had no sales assistance in selling the 70 duplexes on Tract 11451 but at one time did employ a girl for work in the office. She was compensated by Boland on his own account. Mrs. Woodruff continued to be paid as an employee of Artcraft and received no compensation from Boland. In selling the 70 duplexes, signs were at first placed in front of buildings which had vacancies in them. After a short time, this practice was abandoned, to the end that people would then come to the office, from which Boland would send them to the places which were vacant, advising them that if they wanted the property, to come back and "we will do business here". (R. 59-60.)

Boland wrote the copy for and placed and paid for the advertising in the papers of the area. The duplexes were advertised as having been built by Artcraft and as being for sale by the builder. They were

advertised for sale at $11,800 per duplex. Representation was made that "rent of one apartment" would carry "payments on the building". There was no offering, and no sales were made, of any of the 70 duplexes on the basis of single living units; in other words, there was only one buyer for each duplex. (R. 60.)

The first deposit on a property was taken on May 4, 1946, and in approximately ten weeks' time sales had been closed or deposits had been taken on all 70 of the duplexes. So far as appears, the first closing was on June 22, 1946, and the last on September 6, 1946. The date of closing on one sale is not shown, but the deposit in that instance was made on May 6, and the deed was dated May 28. (R. 60.)

After concluding his selling activities in respect of the 70 duplexes on Tract 11451, Boland took a trip back to his home in Missouri. He returned to the Long Beach area about the middle of July and shortly thereafter reached an agreement with Pool and Murphy for the sale of the 100 duplexes on Tract 13163, which apparently was in all material respects the same as that under which the 70 duplexes had been sold. At or about that time, the selling of such housing was made easier due to the fact that through so-called GI loans a veteran could borrow the full price of a property and make a cash purchase without having on his own account to make a down payment. (R. 60-61.)

While in the selling of the 70 duplexes each duplex had been sold to a single purchaser, the advertising of the 100 duplexes suggested two purchasers per

building, and most of them were so sold. In so making these sales, it was assumed that the Bank of America would do the financing, as it had done in respect of the 70 duplexes. But when application was made for financing the sale of a duplex to two veterans, each to own one-half of the building, the bank declined and the completion of the sales of the duplexes on Tract 13163 had to be delayed until the necessary financing could be arranged. Murphy set about the job of arranging the financing, and was so occupied for a period of several weeks. He "finally arranged for it in the East", and most of the sales were thereafter financed by the Massachusetts Mutual Life Insurance Company. Deposits were taken on 20 duplexes in August, the first shown as having been made on August 12. The date of the first deed was September 23, six being shown for that date. (R. 61.)

As in the case of the 70 duplexes on Tract 11451, the 100 duplexes were advertised as having been built by Artcraft and as being for sale by the builder. In one instance the representation was, "It's The Builder That's Selling Them!" The price advertised was $13,000 per duplex. (R. 61-62.)

The selling operation was conducted in substantially the same manner as in the case of the 70 duplexes, except that Boland, for part of the time at least, employed two salesmen to assist him. As before, the selling was done from the Artcraft office, and he was assisted in the office and paper work by Mrs. Woodruff. Boland paid the salesmen, but Mrs. Woodruff received her pay as an employee of Artcraft. (R. 62.)

The selling of the 100 duplexes extended through the remainder of 1946 and into 1947. The first closing was on October 23, 1946, and by the end of July 1947, 99 of the transactions had been closed, three being closed in the latter month. (R. 62.)

Sales of the duplexes would have been facilitated by the existence of vacancies. Due to rent control, however, it was still not possible to have the properties vacated preparatory to sale and in connection with the selling operations the creation of vacancies was encouraged. When the selling of the 70 duplexes on Tract 11451 began, only two units were vacant, but in the course of the selling operations the number increased to thirteen. With respect to the 100 duplexes on Tract 13163, at least 22 units were vacant or became so by the time the sales were concluded. The percentage of tenants who became purchasers was comparatively quite low. (R. 62.)

In selling the 70 duplexes on Tract 11451, and by months, the deposits were taken, escrow was started, deeds were executed and the transactions were closed (R. 62-63), as follows (R. 63):

1946	Deposits Taken	Escrow Started	Deeds Executed	Transactions Closed
May	55	11	8	----
June	8	40	37	19
July	5	12	18	38
August	----	4	7	10
September	----	----	----	1
October	----	1	----	1
	*68	**68	70	***69

* Two dates of deposit are not shown.

** Two dates escrow started also are not shown.

*** One date of closing is not shown.

In selling 99 of the 100 duplexes on Tract 13163, and by months, the deposits were taken, escrow was started, deeds were executed and the transactions were closed, as follows (R. 63):

1946	Deposits Taken	Escrow Started	Deeds Executed	Transactions Closed
August	20	15	----	----
September	27	7	13	----
October	17	25	28	24
November	14	16	20	11
December	5	14	13	17
1947				
January	2	11	13	13
February	1	2	3	18
March	5	1	2	6
April	1	3	2	2
May	----	2	2	2
June	1	2	3	3
July	----	----	----	3
	*93	**98	99	99

* Six dates of deposit are not shown.
** One date escrow started also is not shown.

The 70 duplexes on Tract 11451 were sold for a total of $828,400, 64 being sold at $11,800 per building and 6 at $12,200 per building. The expenses of sale were $45,316.40 and the depreciation, which had been claimed by Associates in its return of income and, so far as appears, had been allowed by the Commissioner, was $52,588.94. (R. 64.)

The 65 duplexes on Tract 13163 sold by Associates in its fiscal year ended January 31, 1947, were sold for a total of $846,250, 60 being sold at $13,000 per building and 5 at $13,250 per building. The selling costs amounted to $42,447.80. The depreciation

claimed by Associates as allowed or allowable on the 65 buildings in its return of income for the fiscal year was $15,314.26. The 34 duplexes on Tract 13163 sold by Associates in the fiscal year ended January 31, 1948, were sold for a total of $442,750, 31 being sold at $13,000 per building and three at $13,250 per building. The selling costs amounted to $23,753.14, and the allowed or allowable depreciation on the 34 duplexes, as shown by Associates on its return for the fiscal year ended January 31, 1948, was $10,592.01. (R. 64.)

On its return of income for the fiscal year ended January 31, 1947, Associates reported gain of $336,947.98 from the sale of the 70 duplexes on Tract 11451 and $413,372.46 from the sale of 65 duplexes on Tract 13163. It reported a loss of $465.18 on some showcases, and a net gain from the sale of the duplexes of $749,856.26, of which it reported $374,928.13 as the amount of taxable net long-term capital gain distributable to the partners. On its return of income for its fiscal year ended January 31, 1948, it reported a gain on the sale of 34 duplexes on Tract 13163 of $217,354.06 and a loss on the sale of building fixtures retired of $1,537.60, or a net gain from the sale of the properties of $215,816.46, of which amount $107,908.23 was shown as the amount of taxable net long-term capital gain. (R. 64-65.)

Each of the taxpayers reported on their returns for 1947, and as long-term capital gain, one-fourth of the amount which had been reported by Associates on its return of income for its fiscal year ended January 31, 1947, as net taxable long-term capital

gain, and on their returns for 1948, one-fourth of the amount similarly shown by Associates on its return of income for the fiscal year ended January 31, 1948. (R. 65.)

For the fiscal years ended January 31, 1945, 1946, 1947 and 1948, Associates realized net rentals from the market building, from the apartment buildings on Tract 11674, from the duplexes on Tract 11451, and from the duplexes on Tract 13163 (R. 65), as follows (R. 66):

Year ended Jan. 31	Market Building	Tract 11674 22 Multiples	Tract 11451 70 duplexes	Tract 13163 100 duplexes	Total Income
1945	$ 2,235.17	$ 4,533.55	$ 9,274.23	.....	$16,042.95
1946	15,994.60	8,399.10	11,356.05	.....	35,749.75
1947	19,567.18	6,997.97	(3,886.13)	$21,597.29	44,276.31
1948	16,008.70	(2,131.51)	.....	(2,491.07)	11,386.12
	$53,805.65	$17,799.11	$16,744.15	$19,106.22	$107,455.13

In 1948 Artcraft built for Pool and Murphy a business building, referred to as the bank building, on land owned by them individually. This property was sold in 1952 through a real estate broker, purportedly to avoid possible foreclosure. The fee, if any, paid by Pool and Murphy to Artcraft for constructing the building does not appear. (R. 66.)

In 1949 arrangements were made with a real estate broker to sell the 22 apartment houses on Tract 11674, and they were sold during the fiscal years 1949 and 1950 for a total profit of $112,414.62. Sale of the one remaining duplex on Tract 13163 was completed on February 28, 1949. (R. 66-67.)

In 1950 Pool and Murphy, in association with Major General Patrick Hurley, formed a corporation in New Mexico, the three individuals being the sole stockholders. The business of the corporation was the building and selling of single-family houses. In 1951 it built and sold 98 such houses. The houses were sold through brokers. Pool was president and Murphy was secretary-treasurer of the corporation, and their duties were the same as their duties had been with Artcraft. Pool and Murphy each received a salary of $500 per week. (R. 67.)

In 1951 the same three individuals organized a corporation in Colorado. Its business was the same as that of the New Mexico corporation. At the time of the trial herein, it had built 192 houses for sale and they were in the process of being sold. The positions held with the corporation and the duties performed by Pool and Murphy were the same as those with the New Mexico corporation. From the Colorado corporation, each of them received a salary of $750 per week. (R. 67.)

Beginning with the employment of Boland, taxpayers began a business of selling real estate, and from April 1946 the 70 duplexes on Tract 11451, and from July 1946 the 100 duplexes on Tract 13163 were held by them primarily for sale to customers in the ordinary course of that business. (R. 70.)

The Tax Court concluded that the duplexes on Tracts 11451 and 13163 were held by taxpayers primarily for sale to customers in the ordinary course of their business and were sold to customers in the ordinary course of that business. (R. 82.) Accord-

ingly, the Tax Court held that the gain realized from sales of duplexes in the taxable years is taxable as ordinary income, rather than as capital gain under 1939 Code Section 117. (R. 80-88.)

SUMMARY OF ARGUMENT

Taxpayers are taxable in 1947 and 1948 on their profit from the sales in 1946 and 1947 of the 70 duplexes in Tract 11451 and 99 of the 100 duplexes in Tract 13163 which had been previously distributed to them by their wholly owned corporation, Artcraft, and were held and sold by Associates, their partnership or joint venture. As the Tax Court held, their profits from the sales are taxable as ordinary income, rather than as capital gain under Section 117.

Section 117 excludes from its operation property held primarily for sale to customers in the ordinary course of a taxpayer's trade or business. The Tax Court held that from April 1946 the 70 duplexes in Tract 11451, and from July 1946 the 100 duplexes in Tract 13163, were held by taxpayers primarily for sale to customers in the ordinary course of their business. As this Court has frequently held, such findings are to be sustained unless they are clearly erroneous. Taxpayers contend that the Tax Court's decision may also be reviewed for error of law but they fail to show wherein the Tax Court adopted an erroneous view of the law.

The Tax Court's findings are amply supported by the evidence. While the duplexes were at first rented, a decision to sell them was made and from that time on (April 1946 as to the 70 duplexes in Tract 11451

and July 1946 as to the 100 duplexes in Tract 13163) they were held primarily for sale. They were sold in such a manner as to constitute a real estate business, rather than the mere liquidation of an investment. A very aggressive and active sales campaign was conducted and the sales were frequent, continuous and substantial. As the Tax Court stated, all of the normal activities which might reasonably be expected in the conduct of an active real estate selling operation were indulged in and, all things considered, it would be difficult to imagine a selling operation or business which was more actively conducted and carried on than the one here. The business was that of taxpayers, not of the real estate agent Boland whom taxpayers employed to do the selling. He had authority to sell only at a fixed price and was to receive $500 for each building he sold. The deeds used in the sales were drawn up by Associates' attorney or at his direction. Taxpayers furnished Boland with an office and office help. His selling activities were conducted from the office of Artcraft, located in the center of Tract 11451, and Artcraft had since 1944 been acting for Associates. Most of the office and paper work was done by Mrs. Woodruff, who was the bookkeeper for both Artcraft and Associates and was paid by Artcraft. The duplexes were advertised as for sale by Artcraft with at times a representation that they were for sale by the builder, including the representation "It's the Builder That's Selling Them!" When difficulties were encountered with respect to the financing of the duplexes on Tract 13163 for prospective purchasers, taxpayer

Murphy himself personally handled the financing arrangements and spent several weeks on it. According to its income tax returns, Associates paid expenses of sale of over $27,000 more than it paid to Boland, whose only expenses were for advertising ($2,500) and for a girl he at one time employed. Taxpayers did not themselves act as salesmen but that was because they were paying Boland to do the selling.

In brief, the duplexes were held for sale and sold in the course of a real estate business which was represented to be that of Artcraft, taxpayers' wholly owned corporation, but was in fact that of Associates, their partnership or joint venture. Clearly, contrary to taxpayers' contention, this is not a case where property was just turned over to a real estate broker to liquidate in the course of his own business and at his own expense. In using a real estate broker, taxpayers conducted a real estate business with respect to these duplexes in the same manner that their wholly owned corporation, Artcraft, had previously conducted a real estate business and in the same manner which two corporations they formed together with General Hurley, to build and sell houses in New Mexico and Colorado, subsequently conducted a real estate business.

ARGUMENT

THE TAX COURT DID NOT ERR IN CONCLUDING THAT THE DUPLEXES ON TRACTS 11451 AND 13163 WERE HELD BY TAXPAYERS PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF THEIR BUSINESS AND, ACCORDINGLY, THAT THE PROFITS REALIZED FROM THE SALE THEREOF ARE TAXABLE AS ORDINARY INCOME RATHER THAN AS CAPITAL GAIN UNDER 1939 CODE SECTION 117

Taxpayers were the members of a joint venture or partnership, called Associates, which they formed for the purpose of holding and dealing with the properties which were distributed to them by their wholly owned corporation, Artcraft. (R. 46-47.) Such property included the 70 duplexes on Tract 11451 and the 100 duplexes on Tract 13163. (R. 44-46, 48-52.) The 70 duplexes on Tract 11451 were sold in 1946 (R. 60) and 99 of the 100 duplexes on Tract 13163 were sold in 1946 and 1947 (R. 62). Since Associates reported its income on the basis of a fiscal year ending on January 31 (R. 47), taxpayers are taxable in 1947 and 1948 on the profits from the sales of the duplexes in 1946 and 1947. They contend that their profits from the sales are taxable as capital gain under Section 117 of the Internal Revenue Code of 1939, *supra*, which, however, excludes from its operation "property held * * * primarily for sale to customers in the ordinary course of" their "trade or business".

A. The "clearly erroneous" rule is applicable in respect of the scope of review

The Tax Court found as facts (R. 70) that "Beginning with the employment of Boland", taxpayers "began a business of selling real estate" and that—

> from April 1946 the 70 duplexes on Tract 11451, and from July 1946 the 100 duplexes on Tract 13163 were held by them primarily for sale to customers in the ordinary course of that business.

As this Court has repeatedly held, such findings are to be sustained unless they are clearly erroneous. *Pacific Homes* v. *United States*, 230 F. 2d 755; *Cohn* v. *Commissioner*, 226 F. 2d 22; *Stockton Harbor Indus. Co.* v. *Commissioner*, 216 F. 2d 638, 640, 650, certiorari denied, 349 U.S. 904; *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263; *Rubino* v. *Commissioner*, 186 F. 2d 304, certiorari denied, 342 U.S. 814; cf. *Homann* v. *Commissioner*, 230 F. 2d 671.

Taxpayers nevertheless make an argument (Br. 23-27) directed, apparently, toward showing that the Tax Court's decision is reviewable "free of the 'clearly erroneous' rule" (Br. 26). Reliance is placed upon decisions (see, e.g., *Galena Oaks Corp.* v. *Scofield*, 218 F. 2d 217, 219 (C.A. 5th)) which, although recognizing the applicability of the "clearly erroneous" rule, have also stated that the rule has no restraining impact *insofar as* the ultimate fact is simply the result reached by processes of *legal* reasoning or the interpretation of the *legal* significance of the facts. Presumably, any Tax Court decision may be reviewed free of the "clearly erroneous" rule if the decision is based upon an erroneous view of the law.

However, contrary to the implication of taxpayers' argument, this is not a case where the Tax Court adopted an erroneous view of the law. Such legal arguments as taxpayers make are specious. They argue that the Tax Court failed to attach proper importance to their investment purpose in acquiring the properties (Br. 29-30) but, since the Tax Court did consider their original purpose (R. 82-83), the argument goes to the weight of the evidence and is therefore factual. Taxpayers also refer to the "repudiated view" of the Tax Court that once a decision to sell is reached the property is *ipso facto* held for sale in the ordinary course of business (Br. 28) but the Tax Court took no such view. It held that the manner in which property is liquidated *may* constitute a business (R. 84) and that on the facts presented in this case the sales of the duplexes *did* constitute a business (R. 85-87). Taxpayers also argue that a large number of sales in a short period of time does not establish a real estate business or sale of property in the ordinary course of business (Br. 46) but the Tax Court did not hold that they do. Similarly, contrary to taxpayers' assertion (Br. 48), the Tax Court did not hold that the use of an "independent real estate broker" is "irrelevant". What the Tax Court held is that the fact that sales are made by "a real estate broker" does not necessarily mean that the selling is not a business of the owners or that the sales are not made in the ordinary course of that business. (R. 84.)

B. The evidence amply supports the Tax Court's finding that the duplexes were held primarily for sale to customers in the ordinary course of taxpayers' business

From a factual standpoint, taxpayers' over-all argument seems to be that they originally acquired and held the duplexes for investment purposes and that in selling them they merely liquidated their investment by an activity which, if it constituted a business, was the business of an independent party, the real estate agent Boland. As we shall separately show below, however, (1) the duplexes were held primarily for sale, (2) the sales thereof were made in such a manner as to constitute a business of selling real estate, and (3) the business was that of taxpayers.

1. ***The duplexes were held by taxpayers primarily for sale***

Since taxpayers place great emphasis upon their alleged original investment purpose, it should be noted at the outset that it is by no means clear that the duplexes were even *originally* acquired and held by the four taxpayers, other than Pool, solely for investment purposes.[4] As to Murphy, as distinguished

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[4] It may also be noted that "investment" is somewhat of a misnomer here. The duplexes were built by Artcraft with F.H.A. insured mortgage loans which were in excess of the cost of the properties and the properties were subsequently distributed by Artcraft to taxpayers (R. 46, 52), who assumed no personal liability on the mortgage loans (R. 45, 51). The mortgage loans attached only to the properties and taxpayers' only obligation was to permit the necessary amount of rentals to be applied to the mortgages. (R. 45-46, 51-52.) As taxpayer Murphy testified (R. 288), "We had no funds invested, that is true".

from Pool, the Tax Court was persuaded that he had no purpose other than to rent *or* sell, depending upon which should prove more profitable (R. 82-83) and, as the Tax Court stated (R. 83), "the record is wholly silent" as to the original intent and purpose of the two wives.

But even if the duplexes had been *originally* held for investment by *all* of the taxpayers, it is sufficient that they were held primarily for *sale* prior to their actual sale. *Home Co.* v. *Commissioner*, 212 F. 2d 637 (C.A. 10th); *Galena Oaks Corp.* v. *Scofield*, 218 F. 2d 217 (C.A. 5th). The tax Court found as facts that the 70 duplexes on Tract 11451 were held primarily for sale "from April 1946" and that the 100 duplexes on Tract 13163 were held primarily for sale "from July 1946" (R. 70), which in each instance was when the decision to sell was made and Boland was employed to sell the particular group of duplexes (R. 57-58, 60-61). Taxpayers impliedly concede the correctness of those findings by stating (Br. 45) that "once a decision to sell is made, the property is of necessity *held* for sale".

2. *The duplexes were held for sale to customers in the ordinary course of business*

Since taxpayers claim that the sales of the duplexes merely constituted a liquidation of their investment, it should be noted, preliminarily, that this was no ordinary liquidation of an investment. In the first place, taxpayers had no "investment" to liquidate (see fn. 4, *supra*); they simply had acquired property, without any investment of their own, from which they could expect to profit through rental or

sale. Secondly, unlike many of the cases where the sale of property has been held to constitute the liquidation of an investment rather than a business,[5] taxpayers were under no compulsion, economic or otherwise, to liquidate their interest in Tracts 11451 and 13163. A liquidation of property connotes the absence of a motive to profit from sales (*Camp* v. *Murray*, 226 F. 2d 931 (C.A. 4th); *Goldberg* v. *Commissioner*, 223 F. 2d 709 (C.A. 5th)), whereas the very reason taxpayers decided to sell these duplexes was that they were persuaded that selling would be more profitable than renting. (See R. 57-58, 58-59, 86, 194-195, 204, 210, 232, 262-263.) Although the rental income was "a lovely setup" according to taxpayer Pool (R. 514), who was reluctant to sell, taxpayer Murphy became convinced that greater profits were to be derived from the marketing of the duplexes (R. 57-59, 86, 194-196), whose market value had practically doubled (R. 194-195), Pool was overridden, and the employment of Boland and marketing of the duplexes was the result (R. 86).

But even assuming that the sales of the duplexes may properly be classified as the liquidation of an investment, the liquidation of an investment may

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[5] *McGah* v. *Commissioner*, 210 F. 2d 769 (C.A. 9th) (liquidation because of bank's demand for payment of indebtedness); *Chandler* v. *United States*, 226 F. 2d 403 (C.A. 7th) (liquidation pursuant to abandonment of unsuccessful business enterprise); *Goldberg* v. *Commissioner*, 223 F. 2d 709 (C.A. 5th) (liquidation resulting from unprofitableness of rental business); *Greenspon* v. *Commissioner*, 229 F. 2d 947 (C.A. 8th) (liquidation in furtherance of severing business connection).

constitute a business, as taxpayers concede (Br. 55) with the citation of a long list of decisions. And see *Magruder* v. *Realty Corp.*, 316 U.S. 69. The favorable capital gain treatment is lost if disposal of the investment property is made in the manner in which the business of selling property is ordinarily conducted. *Ehrman* v. *Commissioner*, 120 F. 2d 607 (C.A. 9th), certiorari denied, 314 U.S. 668; *Palos Verdes Corp.* v. *United States*, 201 F. 2d 256, 257 (C.A. 9th); *Goldberg* v. *Commissioner*, 223 F. 2d 709, 712 (C.A. 5th); *Home Co.* v. *Commissioner*, 212 F. 2d 637, 641 (C.A. 10th); *Galena Oaks Corp.* v. *Scofield*, 218 F. 2d 217, 220 (C.A. 5th). And, of course, if the disposal of the property constitutes a business, "then certainly the sales * * * were to 'customers' in the 'ordinary' course of that business". *Ehrman* v. *Commissioner*, *supra*, p. 610; see also, *Gruver* v. *Commissioner*, 142 F. 2d 363, 368 (C.A. 4th).

The Tax Court found that taxpayers' duplexes were held for sale in "a business of selling real estate" and were sold to customers in the ordinary course of that business. (R. 70.) There can hardly be any dispute as to the correctness of those findings.

When taxpayers decided to sell the duplexes, they employed Boland, a real estate broker (R. 372-373), to do the selling (R. 58, 60-61). They agreed to pay him $500 a duplex as compensation and furnished him with office facilities, including a telephone and some secretarial and office help. (R. 58.) Boland conducted his selling activities in and from the office maintained under Artcraft's name (R. 59, 62), a large one-room

office located in the center of Tract 11451 (R. 198-199). He was assisted in the office and paper work by Mrs. Woodruff (R. 59), the bookkeeper for both Artcraft and Associates who was paid by Artcraft (R. 55), and Boland at one time even employed another girl to help out in the office (R. 59). A Veterans Administration valuation report was obtained. (Resp. Ex. XX, unprinted.) [6] The necessary arrangements were made for the financing of the sales on behalf of the customers. (R. 61.) "For sale" signs were at first placed in front of the duplexes in which there were vacancies but they were taken down because Boland found that his selling operations could more conveniently and effectively be accomplished by directing that prospective buyers come to the office. (R. 59-60, 399.) A very aggressive and active sales campaign was conducted. Advertising was regularly placed in the real estate section of all of the leading newspapers of the area (see R. 60, 61-62, 267, 270, 278-280, 319, 320-322; Resp. Exs. YY. ZZ, AAA, BBB, CCC, DDD, EEE and FFF, unprinted) and in at least three instances Boland was successful in having the properties discussed in a news item appearing in the real estate section of Los Angeles papers (Resp. Exs. ZZ, AAA, and FFF, unprinted). The sales of the duplexes were frequent, continuous and substantial. All told, $2,117,400, (see R. 64), of which $965,672.72 was reported as net profit (R. 64-65), was received

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[6] Pursuant to joint motion filed January 10, 1957, the exhibits are not included in the printed record. (R. 533-535.)

from 169 separate sales which as to the 70 duplexes on Tract 11451 occurred within a period of six months and as to 99 of the 100 duplexes on Tract 13163 occurred within a period of one year (R. 62-63). As the Tax Court stated in its opinion (R. 86, 87)—

> In short, all of the usual and normal activities which might reasonably be expected in the conduct of an active real estate selling operation were indulged in.
>
> * * * *
>
> All of the facts considered, it would be difficult to imagine a selling operation or business which was more actively conducted and carried on than the one here.

Accordingly, this case is favorably comparable to other cases where the selling activity was held to constitute a business rather than the mere liquidation of an investment, such as *Palos Verdes Corp.* v. *United States*, 201 F. 2d 256 (C.A. 9th); *Shearer* v. *Smyth*, 116 F. Supp. 230 (N.D. Cal.), affirmed *per curiam* for reasons stated in opinion of District Court, 221 F. 2d 478 (C.A. 9th); *Home Co.* v. *Commissioner*, 212 F. 2d 637 (C.A. 10th); *Galena Oaks Corp.* v. *Commissioner*, 218 F. 2d 217 (C.A. 5th), and *White* v. *Commissioner*, 172 F. 2d 629 (C.A. 5th). The disposal of the duplexes in the course of what so obviously amounted to a real estate business distinquishes this case from cases cited or relied upon by taxpayers, such as *McGah* v. *Commissioner*, 210 F. 2d 769 (C.A. 9th); *Smith* v. *Commissioner*, 232 F. 2d 142 (C.A. 5th); *Goldberg* v. *Commissioner*,

223 F. 2d 709 (C.A. 5th); *Victory Housing No. 2, Inc.* v. *Commissioner*, 205 F. 2d 371 (C.A. 10th).

3. ***The business was that of taxpayers, not Boland***

Taxpayers contend that the Tax Court erred in finding that it was *taxpayers'* business in which the sales of their duplexes were made. (Br. 47-53.) Their argument is that Boland, the real estate agent employed by them, was an "independent contractor" (Br. 47, 53) or "independent broker" (Br. 49) and that it was therefore his, rather than taxpayers', business in which the sales of the duplexes were made.

But, contrary to taxpayers' assumption (Br. 47, 49), we are not here concerned with the technical, common law concept of an "independent contractor". A real estate broker normally acts as the agent of others. Accordingly, in cases involving the question whether property was held primarily for sale to customers in the ordinary course of a taxpayer's business, the courts, including this Court, have repeatedly stated or held that a real estate business may be conducted by a taxpayer through others, such as a real estate broker. See *Richards* v. *Commissioner*, 81 F. 2d 369 (C.A. 9th); *Welch* v. *Solomon*, 99 F. 2d 41, 43 (C.A. 9th); *Commissioner* v. *Boeing*, 106 F. 2d 305, 309 (C.A. 9th), certiorari denied, 308 U.S. 619; *Homann* v. *Commissioner*, 230 F. 2d 671 (C.A. 9th); *Gruver* v. *Commissioner*, 142 F. 2d 363 (C.A. 4th); *Snell* v. *Commissioner*, 97 F. 2d 891, 892-893 (C.A. 5th); *Brown* v. *Commissioner*, 143 F. 2d 468 (C.A. 5th); *McFaddin* v. *Commissioner*, 148 F. 2d 570 (C.A. 5th); *Gambler* v. *Commissioner* (C.A.

5th), decided March 21, 1957 (1957 P-H, par. 72,-581). As this Court long ago stated in *Welch* v. *Solomon, supra*, p. 43—

> The personal attention which a taxpayer gives to a business is certainly not decisive as to whether a resulting profit is ordinary income or capital gain. One may conduct a business through others, his agents, representatives, or employers. The business is nonetheless his because he chooses to let others bear all of the burdens of management.

There may be isolated instances where sales of a taxpayer's property are made through the efforts of a broker carried out independently of the taxpayer's business and conducted as a part of the broker's own business and at his own expense, but even *Smith* v. *Dunn*, 224 F. 2d 353 (C.A. 5th), where that was the situation, recognizes (p. 356) that the real estate business may be "conducted through a representative" by being carried on "primarily in behalf of the taxpayer".

The present case is one where the real estate business was conducted by a real estate agent primarily on behalf of taxpayers and was therefore taxpayers' business. Boland was a licensed real estate broker (R. 57, 372-373) but, so far as appears, he had no office in the Los Angeles area and was not even permanently located there. After getting out of the Air Force, he induced taxpayers to permit him to sell the duplexes, first the 70 in Tract 11451 and, when those were sold, the 100 in Tract 13163. (R. 57-58, 60-61.) For his services, he at first sought

the straight five per cent selling commission, which was "more or less traditional" in that area, but after some discussion taxpayers agreed to pay him $500 for each building he sold and to supply the office facilities, including telephone and some secretarial and office help. (R. 58, 60-61.) The deeds used in the sale of the duplexes were drawn up by Associates' attorney or by someone else at his direction. (R. 502.) Boland's authority was to sell the duplexes at a fixed price. (R. 388.) He conducted his selling activities from the office of Artcraft (R. 59), taxpayers' wholly owned corporation which since 1944 had been acting for Associates (taxpayers' partnership or joint venture) (R. 446), which had no office of its own (R. 55, 294). The Artcraft office was a large one-room office located in the center of Tract 11451 (R. 198-199) and had the sign "Artcraft Builders, Inc." across the front and on the windows (R. 399). The duplexes were advertised as having been built by Artcraft and as being for sale by Artcraft (rather than by Boland), with at times specific representations that the duplexes were for sale by the builder, including a representation that "It's The Builder That's Selling Them!" (See R. 60, 61-62, 267, 270, 278-280, 319, 320-322; Resp. Exs. YY, ZZ, AAA, BBB, CCC, DDD, EEE and FFF.) Mrs. Woodruff, who kept both Artcraft's and Associates' books and was paid by Artcraft (R. 55, 294, 398, 453, 480), worked in the Artcraft office from which Boland conducted his selling activities (R. 398). She gave Boland "a great deal of help" (R. 393), as he testified, and rendered that help as part of the arrange-

ment with taxpayers. Indeed, it is rather obvious from the evidence that Mrs. Woodruff (paid by Artcraft, not Boland) did all of the office and paper work (see R. 393, 403-404, 424, 476-478, 491, 492-493, 498, 503, 511) except for such help as she had from a girl Boland at one time employed (R. 59). Boland testified that he did not pay much attention to details, which were to be taken care of by others—that his "job was to sell and keep them [the duplexes] sold". (R. 423.) When difficulties were encountered with respect to the financing of the duplexes on Tract 13163 for prospective purchasers, taxpayer Murphy himself personally handled the financing arrangements and spent several weeks on it. (R. 87, 337-338, 389-390, 483.) At least one letter went out on Artcraft's stationery signed by Boland as representing Artcraft. (Resp. Ex. GGG, unprinted.) According to its income tax returns, Associates paid a total of $111,517.34 as expenses of the sale of the 169 duplexes sold in 1946 and 1947 (see R. 64), which was $27,017.34 more than it paid to Boland. The only expenses Boland had were for advertising ($2,500) and for the girl he at one time employed. (R. 385.) For part of the time he hired two salesmen to help him sell the 100 duplexes on Tract 13163 (R. 62) but the arrangement there was no doubt the customary one between real estate agents. Taxpayers Pool and Murphy did not themselves actively attempt to sell but taxpayer Murphy testified (R. 285) that "I did not intend to pay Boland, and I don't think Mr. Pool did, $85,000.00 for selling those

buildings and then turn around and do the work for him".

In brief, therefore, the evidence shows that Boland's selling activity was conducted on behalf of taxpayers in a real estate business which was represented to be that of Artcraft (as distinguished from that of Boland) but was in reality that of Associates (taxpayers' partnership or joint venture). In using a real estate agent to do the selling, taxpayers (in partnership as Associates) conducted a real estate business, as related to these 170 duplexes, in the same manner that their wholly owned corporation (Artcraft) had previously conducted a real estate business (see Stip., par. 10, R. 19; R. 84-85, 145-146) and in the same manner that two corporations they formed together with General Hurley, to build and sell houses in New Mexico and Colorado, subsequently conducted a real estate business (see R. 67, 245, 506). The use of a real estate broker was "standard procedure" with Pool (R. 523), who had been in the real estate business in one form or another all of his life (R. 35). This simply is not a case where property was just turned over to a real estate broker to liquidate in the course of his own business and at his own expense. The evidence of the conduct of a real estate business with respect to these 170 duplexes is certainly as strong as, if not stronger, than the evidence in other cases where the business was held to be that of the taxpayer although the selling was done by a real estate broker. See *Homann* v. *Commissioner*, 230 F. 2d 671 (C.A. 9th); *Commissioner* v. *Boeing*, 106 F. 2d 305 (C.A. 9th), certiorari

denied, 308 U.S. 619; *Gambler* v. *Commissioner* (C.A. 5th), decided March 21, 1957 (1957 P-H, par. 72,-581); *Brown* v. *Commissioner*, 143 F. 2d 468 (C.A. 5th); *McFaddin* v. *Commissioner*, 148 F. 2d 570 (C.A. 5th); *Gruver* v. *Commissioner*, 142 F. 2d 363 (C.A. 4th).

CONCLUSION

The decisions of the Tax Court are correct and should be affirmed.

Respectfully submitted,

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